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JUN 15 2011

George Mathieus, Administrator
Planning, Prevention, and Assistance Division
Department of Environmental Quality
1520 E. Sixth Avenue
P.O. Box 200901
Helena, MT 59620-0901

Re: EPA Interpretation of Montana's Draft Nutrient Trading Policy

Dear Mr. Mathieus:

EPA appreciates the opportunity to provide comments on the August 2, 2010 draft nutrient trading policy developed by the Montana Department of Environmental Quality (DEQ). EPA supports the State's efforts to utilize trading as another tool to assist with reducing nutrient loads across Montana, and recognizes the need to provide innovative approaches that help stakeholders achieve cost-effective, near-term nutrient reductions. Throughout 2010, EPA provided informal comments on Montana's draft policy and met with DEQ staff to discuss our concerns. In response to your staff's request, this letter provides additional detail and clarification on EPA's position regarding DEQ's current draft trading policy. Our comments are intended to ensure that DEQ's policy is consistent with the Clean Water Act, EPA's Water Quality Trading Policy (2003) and the technical guidance in EPA's Water Quality Trading Toolkit for Permit Writers (2007). The letter specifically addresses the generation and use of tradable pollution reduction credits in watersheds for which there is a Total Maximum Daily Load (TMDL), and outlines different approaches the State may employ to increase the flexibility of its nutrient trading program.

Credits and Load Allocations in Montana's Trading Policy:

DEQ's draft trading policy outlines the situations in which nonpoint sources may generate credits. On page 3 of the draft policy, DEQ specifies that:

> "A nonpoint source may generate credits by achieving nutrient reductions greater than required by a regulatory requirement applicable to that source. Nonpoint source credits will be based upon a measured or estimated reduction of nutrients adjusted to account for applicable trading ratios. For example, such loads may be calculated by using watershed model delivery ratios that will be applied to edge-of-fields loads or may be calculated by a model used in a Department-approved TMDL."

From our discussions with the State, it is EPA's understanding that DEQ interprets this language to mean that nonpoint sources can generate credits as soon as they begin to reduce their nutrient load. DEQ considers these credits to be available for purchase by point sources assigned a waste load allocation (WLA) in a TMDL. Because TMDL load allocations (LAs) are not part of DEQ's nonpoint source baseline, the proposed trading policy would allow for generation of trading credits before a nonpoint source LA has been met. While EPA understands and agrees with DEQ's position that any nutrient reduction benefits the environment, we differ on what constitutes an allowable trading credit.

EPA's trading policy states that, where a TMDL is in place, the LA serves as the baseline for nonpoint sources to generate credits. Generating trading credits before a nonpoint source LA has been met is problematic because of the relationship between TMDLs and the permitting process. Federal and state law requires DEQ to establish TMDLs for water quality-impaired segments "at levels necessary to attain and maintain the applicable narrative and numerical WQS." 40 C.F.R. § 130.7(c)(1), MCA 75-5-703(1). A TMDL consists of "the sum of individual WLAs for point sources and LAs for nonpoint sources and natural background." 40 C.F.R. § 130.2(i), MCA 75-5-103(37). When developing a TMDL, DEQ establishes the WLAs and LAs in a TMDL by calculating the greatest amount of loading that the impaired water can receive without violating the applicable water quality standard and allocating this "loading capacity" between point sources and nonpoint sources. 40 C.F.R. § 130.2(f), MCA 75-5-103(18). Any loading from point sources and nonpoint sources that exceeds the total loading capacity in a TMDL will result in an exceedance of the applicable water quality standard.

While TMDLs are not independently enforceable, their WLAs become enforceable when they are incorporated into MPDES permits for point sources as water quality-based effluent limitations (WQBELs). Federal and state law requires DEQ to ensure that "effluent limits developed to protect a narrative water quality criterion, a numeric water quality criterion, or both, are consistent with the assumptions and requirements of any available wasteload allocation for the discharge prepared by the State and approved by EPA pursuant to 40 CFR 130.7." 40 C.F.R. § 122.44(d)(1)(vii)(B), ARM 17.30.1344(2)(b). Moreover, effluent limitations in DEQ's permits must "control all pollutants or pollutant parameters . . . which the Director determines are or may be discharged at a level which will cause, have the reasonable potential to cause, or contribute to an excursion above any State water quality standard." 40 C.F.R. § 122.44(d)(1)(i), ARM 17.30.1344(2)(b). Under its draft Trading Policy, DEQ could issue a permit that allows the permittee to buy credits from nonpoint sources to meet its permit limits, even though the nonpoint sources have not met their LAs under the TMDL. Because the reductions achieved by the nonpoint source will be counted twice (i.e., as an actual reduction towards meeting an LA and as a credited reduction towards meeting a WLA), the net result of these transactions is point source and nonpoint source discharges that exceed the loading capacity identified in the TMDL. As noted above, an exceedance of the loading capacity in a TMDL results in an exceedance of the applicable water quality standard. In this scenario, therefore, the permit appears inconsistent with the TMDL, the permitted discharge appears to contribute to an excursion above a State water quality standard, and the permit would seem to violate 40 C.F.R. §§ 122.44(d)(1)(i) and (vii)(B), as well as ARM 17.30.1344(2)(b).

Examples of state policies with trading policies, and definitions of "baseline", that EPA supports include:

- *Maryland:* http://mdnutrienttrading.org/docs/Phase%20II-A_Crdt%20Generation.pdf
- *Virginia*: http://www.deq.virginia.gov/export/sites/default/vpdes/pdf/VANPSTradingManual_2-5-08.pdf. Starting on page 6.
- *Michigan:* http://www.state.mi.us/orr/emi/admincode.asp?AdminCode=Single&Admin_Num=323030001&Dpt=EQ&RngHigh (R323.3008. Michigan's definition is as follows:

> "(c) The nutrient cap, point source waste load allocations and nonpoint source load allocations shall constitute the respective baselines for the generation, use, and trading of credits."

Approaches to Provide Flexibility in a Trading Program

EPA recognizes that the regulatory constraints imposed on trading in watersheds with a TMDL outlined above may reduce the flexibility available to stakeholders seeking to achieve immediate improvements in water quality. EPA believes, however, that there are other opportunities that provide flexibility while ensuring compliance with the Clean Water Act. These opportunities include: 1) allowing trading of credits produced in watersheds with disaggregated nonpoint source load allocations, 2) allowing offsets in watersheds with impaired streams where the TMDL has not yet been completed, and 3) allowing offsets in non-TMDL watersheds. Each of these is discussed below.

EPA does not expect all nonpoint sources in a watershed to meet an aggregate LA before any single nonpoint source may generate credits. The State's policy can allow individual nonpoint sources in a TMDL watershed to generate tradable credits regardless of whether the total LA for nonpoint sources has been met. In this situation, LAs would be disaggregated and apportioned among individual nonpoint sources. Individual nonpoint sources would establish BMPs to reduce nutrient loadings to meet their portion of the LA. The individual nonpoint sources would generate credits that could be sold to point sources if they reduced their nutrient loading beyond the LA. This approach may require some additional work by the State to develop and adopt a methodology for apportioning LAs among individual nonpoint sources, but it provides incentive for motivated nonpoint sources to begin implementing pollution controls.

Another option that EPA believes would be useful in Montana is the use of offsets in watersheds which have been placed on the State's 303(d) list, but for which a TMDL is not yet complete. In these watersheds, because the state has not yet adopted WLAs and LAs, the WQBELs in point source permits are not tied to nonpoint source loadings in any way. As a result, any nonpoint source load reduction, beyond those required by state or local laws, may be used to offset a point source's WQBEL without running the risk of the point source discharge causing or contributing to a violation of a water quality standard. Once a TMDL is complete, of course, the LA would

constitute the trading baseline, the same permitting requirements outlined in the first section above would apply and the NPS would be required to meet their LA before generating any additional credits.

Similar trading opportunities also exist in non-TMDL watersheds. Again, because there is no TMDL, point sources are not assigned WLAs and can purchase nonpoint source offsets to meet their WQBELs without having to address baseline concerns.

While these options for flexibility focus mainly on broad policy approaches, EPA would like to reiterate that there are many possible trading and funding strategies that may afford the State flexibility. These might include a septic hookup trading program, joint point source/nonpoint source cooperatives, federal/state funding programs, or others. We would encourage DEQ to develop alternative trading and funding strategies and commit to working with you to ensure these options meet the needs of your stakeholders while complying with our permitting regulations. When developing such strategies, EPA's Water Quality Trading Toolkit provides case examples and additional details that may be useful. It can be found at:

http://water.epa.gov/type/watersheds/trading/WQTToolkit.cfm.

Summary

We hope this letter clarifies EPA's concerns with DEQ's draft trading policy and clearly identifies the underlying regulatory requirements. EPA strongly supports the adoption of policies that provide flexibility in a trading program while ensuring that permittees remain in compliance with the Clean Water Act. EPA welcomes clarification from DEQ as to whether our interpretation of the State's draft trading policy is accurate. We also invite DEQ to reconsider our October 2010 request that DEQ provide a written rationale for issuing a permit where the LA has not been met. This documentation may help us understand DEQ's legal basis for issuing a permit in these scenarios.

In closing, we appreciate the State's hard work to develop a nutrient trading policy, and hope to work closely with the State to develop a final trading policy that provides incentive to reduce nutrients while ensuring compliance with the Clean Water Act. If you have any questions about this letter or its conclusions, please feel free to contact Everett Volk, in our Office of Regional Counsel, at 303-312-7290, or Tina Laidlaw, of our Montana Operations Office, at 406-457-5016.

Sincerely,

Julie DalSoglio

Julie DalSoglio, Director
Montana Operations Office

cc: Claudia Massman, MTDEQ
Mark Bostrom, MTDEQ
Jenny Chambers, MTDEQ
Todd Teegarden, MTDEQ